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FM AMEMBASSY LIMA
TO RUEHC/SECSTATE WASHDC 3859
INFO RUEHBO/AMEMBASSY BOGOTA 4331
RUEHBU/AMEMBASSY BUENOS AIRES 2774
RUEHCV/AMEMBASSY CARACAS 0141
RUEHQT/AMEMBASSY QUITO 0990
RUEHLP/AMEMBASSY LA PAZ FEB SANTIAGO 1099
RUEHBJ/AMEMBASSY BEIJING 0386
RUCPDO/DEPT OF COMMERCE WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHDC
RHEFDIA/DIA WASHINGTON DC
RHMFIUU/CDR USSOUTHCOM MIAMI FL
RHEHAAA/NATIONAL SECURITY COUNCIL WASHINGTON DC

UNCLAS LIMA 000330

SIPDIS

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COMMERCE FOR 4331/MAC/WH/MCAMERON
TREASURY FOR AJEWELL

E.O. 12958: N/A

TAGS: [ETRD](#) [EINV](#) [EFIN](#) [PREL](#) [TBIO](#) [PE](#) [CH](#)

SUBJECT: PERU-CHINA TRADE DIVERSIFIES, BUT INVESTMENT STRUGGLES

¶1. Summary: With a bilateral trade relationship growing stronger, the GOP is trying to attract increased Chinese investment to Peru. Since 2004, China has overtaken the United Kingdom and Chile to become Peru's second largest export market and second largest import market (behind the U.S.). Peruvian trade with China is mostly focused on minerals exports, but recent figures for 2006 show agricultural exports to China increasing by more than 100 percent (year on year growth). Trade Minister Mercedes Araoz has even floated the idea of a free trade agreement with China, but faces internal pressure from sectors such as textiles that complain from unfair competition.

¶2. Chinese foreign direct investment in Peru is still small compared to U.S. and European FDI in Peru, and it is concentrated in mining. The single largest Chinese investment in Peru has been in an iron ore mine, but the project has been burdened by labor problems and operating losses. Nevertheless, it is clear that despite those difficulties, China views Peru as an important investment destination, judging from a recent official tour of Peru by Chinese investors, publicity over recently-arrived Hong Kong bank HSBC and the announcement at the November 2006 Hanoi APEC summit of the PRC's official invitation to President Alan Garcia to visit China. End Summary.

MINIMAL CHINESE INVESTMENT

¶3. With \$122.2 million in 2005, China's share of the \$14 billion of Foreign direct investment in Peru was only 0.86 percent, far below U.S. and Spanish investments of over \$4 billion each. Despite this comparative difference, the Chinese have started to invest more significant amounts, mostly in the mining sector.

PROFITS AND PROBLEMS AT IRON ORE MINE

¶4. China's main investment in Peru is the Shougang Steel Corporation's 1992 purchase of an iron ore mine in central Peru. Shougang (formerly known as the Capital Iron And Steel Company) is one of China's oldest state-owned companies, and China's fourth largest steelmaker. In 1992, Shougang paid \$118 million for the state-run Steel Peru mine to create Shougang Steel Peru S.A.A, Peru's main iron ore producer. Shougang Steel Peru's mining and processing plants are located in a desert area called Marcona (about

250 miles south of Lima). The company registered exports of \$256 million in 2006, an increase of more than 18 percent over 2005.

15. Despite these profits, Shougang Steel Peru has been plagued by strikes and worker unrest, and the conflict is frequently in the headlines. The Chinese management's differences with labor unions and local politicians led recently to a five-month strike that began in June 2006. The strike forced management to shut down production for several months. It was settled in October 2006, and resulted in some improvement in equipment, working conditions and wages. Actual losses were not published, but the media estimates that the company lost over \$3 million in sales. Observers familiar with the plant say the Chinese have made minimal actual investment in the plant's production or equipment since it took over.

16. The GOP has recently hosted two visiting Chinese business investment delegations, including one in November 18-25, focusing mostly on gold, coal, steel, and phosphate production, as well as in the construction, road, energy generation, plastics, real estate, chemical, computer, agricultural machinery, textile, and service industries. The GOP has also established a Peru-China Business Committee to foster commercial and investment relations between the two countries. This committee is made up of Peruvian companies such as Sociedad Agricola Drokasa (agriculture), Inca Tops (textiles), Corporacion Pesquera Inka (fishing), Sunshine Export, Banco Interbank (banking), among others.

EXPORTS TO CHINA: FOCUSED ON MINERALS

17. While the U.S. remains the main destination for Peruvian exports (\$5.2 billion in 2006), China is now the second largest export market for Peruvian products with exports to China totaling \$2.2

billion in 2006, an increase of more than 200 percent over \$597 million exported in 2002. Minerals increased their share of total exports to China, growing to \$1.5 billion in 2006 from \$256 million in 2002. Total Peruvian exports for 2006 were \$23.4 billion.

Top Six Peruvian Products Exported to China (in USD millions)

Product	2005	2006	Percent Change
Copper Concentrates	502.7	926.9	84.4
Fish Meal	585.5	427.8	-36.9
Lead Concentrates	139.8	271.7	94.3
Molybdenum	220.8	103.7	-112.9
Petroleum Bitum Oil	17.0	99.7	486.5
Iron Concentrates	142.1	86.2	-64.8

(Source: Adex, SUNAT)

18. Exports to China are dominated by a few mining companies, among them Antamina Mining Company (33.96 percent of total exports) with \$769 million, followed by Shougang Steel Peru (6.93 percent), Southern Peru Copper (6.08 percent), and BHP Billington Tintaya (4.59 percent).

19. While starting from a small base, Peru's agricultural exports to China have been showing impressive growth: from \$1.7 million in 2005 to \$4.6 million in 2006 (an increase of more than 170 percent).

The top five agro industrial export categories were processed seaweed (32.6 percent), grapes (24.4 percent), tara (tally stick 18.7 percent), strawberries (6.8 percent), and canned tomatoes (4.9 percent).

IMPORTS FROM CHINA: TWENTY-FOLD GROWTH

10. Imports from China to Peru have shown astronomical growth, jumping from \$41.6 million in 2002 to \$910 million in August 2006. Products imported from China have moved from basic (artificial fiber textiles, toys, and dolls) to more sophisticated value-added ones, like electronics (televisions, telephones, and radios).

Peruvian Imports from China 2005-2006

(in USD millions)

Product	2005	2006 (to August)
Machine Parts and Accessories	18.5	29.2
Memory Units	22.0	22.7
Telephones	21.3	22.5
Radio Receptors	24.2	20.3
Motorcycles	21.5	20.0
Other Input Output Units	15.7	18.6

(Source: Adex, SUNAT)

¶11. The GOP has tried to promote increased trade with China, and in September 2006 Trade Minister Mercedes Araoz floated the idea of negotiating a free trade agreement with China. This announcement was met with criticism by Peru's local textile sector. Local textile companies are in fact lobbying to impose safeguards on textile imports from China. In a recent safeguards action, INDECOPI (National Institute for Defense of Competition and Intellectual Property) ruled that no harm was caused to the local industry by Chinese textile imports. In fact, INDECOPI noted that there actually was an increase in tax revenue for the government as well as an increase in employment because of Chinese imports.

¶12. In April 2006, the Hong Kong-Shanghai Banking Corporation (HSBC Bank Peru S.A., the wholly owned subsidiary of HSBC Latin American Holdings (UK) Limited) received authorization by Peru's supervising body to start banking operations in Lima in October 2006. HSBC Peru officials said they would focus their activities on the corporate banking sector and local and international companies with a level of sales superior to US\$ 20 million, as well as some commercial banking. At a recent event, the bank's management said HSBC was bullish on the economic outlook of the Peruvian economy and its prospects for long-term growth.

THE ROAD AHEAD

¶13. Despite Shougang's difficulties and the bad press these have given China here, the trade and investment relationship continues to strengthen. The increase in non-mineral exports is encouraging Peru's counter-cyclical agricultural exporters of fruits and vegetables. While minerals still fetch top dollar in China, the GOP, according to Juan Carlos Rios, Peru's Commercial Counselor based in Beijing, is encouraging Peru's exporters to focus on satisfying Chinese domestic demand with more value-added products in the areas of agriculture, fishing, textiles, and mining, and focusing on quality rather than volume. With the GOP preparing to host APEC in 2008, we expect even greater interest from Beijing in the rapidly expanding Peruvian economy.

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